

91

1 which my counsel indicated was collateralized,  
2 but was not a security interest.

3 And interest has been running for a  
4 year on that -- on those judgments entered by the  
5 United States District Court. So my assumption  
6 that the total amount is in excess of \$550  
7 million, in my view, is fairly accurate.

8 Q. But the settlement does not allow any --  
9 doesn't allow the Trustee to contest the amount  
10 of that allowed unsecured claim down the road,  
11 other than money that may come back in as a  
12 result of this litigation being overturned;  
13 correct?

14 A. Well --

15 THE COURT: It's an agreement. It's  
16 a settlement.

17 They're fixing their claim. I think  
18 that you're forgetting that this is all on the  
19 record as a proffer.

20 And it's -- the hour is growing  
21 late. And to go over ground that already is in  
22 the proffer, I don't see as terribly productive.

23 Mr. McMichael put the proffer in.  
24 Let's move on.

1 BY MR. STERN:

2 Q. Do any of the unsecured creditors have the  
3 right to contest the proof of claim filed by  
4 Royal under your settlement agreement?

5 A. There's no mention of the rights of  
6 anyone. Is that a legal question or a factual --

7 Q. No. As the Trustee, would you object if  
8 another creditor of the estate objected to the  
9 proof of claim asserted by Royal?

10 A. Oh, Royal would object.

11 Q. I'm asking whether the Trustee would  
12 object.

13 A. I've stood by the claims submitted here.  
14 I don't know if it's my responsibility to object.

15 I don't --

16 Q. Would it --

17 A. Why would I? I mean, I'm sorry.

18 You're asking the questions.

19 Q. No. I want you to finish.

20 I apologize.

21 Well, I think we can all agree that  
22 part of the settlement that is the allowance of  
23 a -- of the claimant management, it would bar the  
24 unsecured creditors.

93

1 THE COURT: Are you asking me or the  
2 witness?

3 THE WITNESS: Isn't that what  
4 allowance means?

5 MR. STERN: That's correct.

6 THE COURT: Okay.

7 THE WITNESS: If the Court -- if  
8 the -- if the claim was allowed and the Court  
9 approves it, an objection would be -- would be --  
10 I suspect it would be overruled and not  
11 sustainable.

12 BY MR. STERN:

13 Q. So the bottom line is that at the end of  
14 the day, there will be, under your analysis, very  
15 little available for the unsecured claims which  
16 amount to about \$60 million?

17 A. That's -- you're here. If you object, so  
18 state it.

19 But the answer to your question is,  
20 at the end of this hearing, it's my assumption,  
21 if the Court approves it, the Court may not  
22 approve it, but if the Court approves it, then  
23 anyone seeking to object will be summarily  
24 dismissed.

---

1 Q. How would it be a detriment to the estate  
2 to allow the claims, subject to the rights of  
3 other creditors, to come in and object?

4 MR. WOLFSON: Objection, Your Honor.  
5 It's way beyond the scope.

6 This is -- it has nothing to do with  
7 the reasonableness of this settlement asking the  
8 witness' opinion of some other hypothetical  
9 situation.

10 THE COURT: Well, I assume what he's  
11 asking is why did you negotiate that? And I  
12 think the answer is pretty obvious that that  
13 wasn't the deal.

14 MR. WOLFSON: That's not the deal we  
15 assume we're going to.

16 THE COURT: If you want to examine  
17 him on what other settlements he might have  
18 entered into, that Royal would not have agreed  
19 to, I guess you can ask that question.

20 MR. STERN: No. That would be  
21 argument.

22 THE COURT: It seems to me the  
23 answer is pretty obvious.

24 MR. STERN: It would be argument.

1 And I don't need to ask him that.

2 I don't have any further questions.

3 THE COURT: Thank you.

4 Anyone else want to examine this  
5 witness?

6 Redirect?

7 MR. McMICHAEL: Brief redirect.

8 BY MR. McMICHAEL:

9 Q. Mr. Stanziale, you have the settlement  
10 term sheet in front of you?

11 A. Yes, I do.

12 Q. Could you look at the paragraph that deals  
13 with Paragraph 6? I just want to deal with these  
14 off-the-record so-called side agreements.

15 A. I see it.

16 Q. Do you see Paragraph 6? Could you explain  
17 to the Court why it is that the settlement  
18 threshold described in Paragraph 6 is not put in  
19 the record?

20 THE COURT: Mr. McMichael, this is  
21 the Pepper Hamilton one?

22 MR. McMICHAEL: I'm sorry?

23 THE COURT: Is this the Pepper  
24 Hamilton one, so-called side agreement?

1 MR. McMICHAEL: Yes.

2 THE COURT: Okay.

3 THE WITNESS: Well --

4 BY MR. McMICHAEL:

5 Q. Do you just want to put that in the  
6 record?

7 A. First of all -- first of all, Royal has a  
8 cause of action of its own, if it wishes to  
9 proceed against Pepper Hamilton. And Pepper  
10 Hamilton, if Pepper Hamilton sought to negotiate  
11 a settlement with the estate, with the Trustee,  
12 it's our view that they wouldn't proffer money to  
13 the Trustee, and then leave themselves open to a  
14 lawsuit, another lawsuit, possibly under the same  
15 set of facts, absent collateral estoppel, et  
16 cetera.

17 So any settlement that we would  
18 enter into with -- if we were fortunate to do so  
19 with Pepper, would necessarily require a sign off  
20 from Royal.

21 Now, why do we not set forth that  
22 amount in here? What this agreement says is that  
23 there's a minimum amount that Pepper would agree  
24 to without any further opportunity to object.

1                   And so we came to a conclusion as to  
2    what that amount would be. If the amount that we  
3    would settle for is under this amount that Royal  
4    feels is justifiable, Royal can either say, Yeah,  
5    I'll go along with it, or say, No, I'm not going  
6    to go along with that.

7                   But any amount that we settle for  
8    over this particular amount, Royal will have no  
9    say in whether the estate accepts that settlement  
10   or not.

11           Q.    Would it be a bargaining disadvantage for  
12   the Trustee in trying to settle a claim against  
13   Pepper Hamilton for Pepper to know that amount?

14           A.    Of course, it would.

15           Q.    Okay. And isn't that why you didn't put  
16   it in the agreement?

17           A.    Yes, it is.

18           Q.    Okay. And is it true that we have a side  
19   letter with Royal that documents that amount?

20           A.    Yes, we do.

21           Q.    Okay. And have you authorized us to file  
22   that under seal?

23           A.    Yes, I have.

24           Q.    Okay. So you're not attempting to hide it

1 from the Court?

2 A. No, I'm not.

3 Q. You just don't want Pepper to find out  
4 about it, because of the obvious implications; is  
5 that correct?

6 A. Yes.

7 Q. Is the same thing essentially true with  
8 respect to the threshold amount for the  
9 settlement of Chapter 11 administrative claims  
10 that appears in Paragraph 8, same basic theory?

11 A. Yes.

12 Q. Okay. We have a side letter?

13 A. Yes.

14 Q. And you've authorized us to file that  
15 under seal with the Court --

16 A. Yes.

17 Q. -- if the Court wants to inspect it?

18 A. Yes.

19 Q. But, obviously, it would be an advantage  
20 to those admin creditors from the Chapter 11 if  
21 they knew what that number was; right?

22 A. Yes.

23 Q. All right. Now, let's just talk about  
24 admin claims for one more second, and then I'll



1 sit down.

2 You were asked a lot of questions  
3 about administrative claims. So let me just go  
4 over it with you again, so we are clear what  
5 we're talking about.

6 You said there was \$4 million of  
7 administrative claims. Isn't it true that about  
8 two million of it was from the chapter?

9 A. Yes.

10 Q. About half of it?

11 A. Yes.

12 Q. And isn't it true that under Paragraph 8,  
13 as long as we meet our target, Paragraph 8 of the  
14 term sheet, Royal will withdraw its \$7 million  
15 claim?

16 A. Yes.

17 Q. So that comes out.

18 And do you have objections? If you  
19 can't resolve the Chapter 11 admin claims, do you  
20 have objections to those claims?

21 A. Yes.

22 Q. And last, but not least, the 1.9 million  
23 dollar admin claim that Royal gets under this  
24 agreement, they can't take that out of your \$3

100

1 million settlement; right?

2 A. No.

3 Q. All right. One more question.

4 Is there money in the estate --

5 A. Yes.

6 Q. -- today?

7 A. Yes.

8 Q. Without the settlement, there is cash in  
9 the estate?

10 A. Yes.

11 MR. McMICHAEL: That's all I have,  
12 Your Honor. I'll have some argument if the Court  
13 wants to hear it later.

14 THE COURT: Any recross?

15 MR. KORTANEK: No, Your Honor.

16 MR. STERN: No, Your Honor.

17 THE COURT: Thank you,

18 Mr. Stanziale, you may step down. Any other  
19 evidence from the moving party?

20 MR. McMICHAEL: No, sir. The  
21 Trustee rests.

22 THE COURT: All right. Any  
23 witnesses from the other side?

24 MR. KORTANEK: NO, Your Honor.

101

1 MR. STERN: No, Your Honor.

2 THE COURT: Very well. I'll hear  
3 argument.

4 MR. KORTANEK: Your Honor, the CDI  
5 schools have objections that are on three  
6 principal grounds.

7 One is the delegation concept.

8 Two is process.

9 And three is what I'll call merits  
10 of the settlement.

11 On the point of delegation, Your  
12 Honor, I think that Cybergenics is an important  
13 milestone, but it is only a starting point.

14 First, I think that Mr. Wolfson  
15 turns Cybergenics on its head a little bit. It  
16 is, indeed, a case where the Third Circuit, and  
17 then the On Bonk Third Circuit was only deciding  
18 whether a committee should be delegated estate  
19 causes of action. But it is definitely a fair  
20 characterization that it wrestled with that  
21 concept mightily.

22 THE COURT: But let me understand  
23 them. These -- delegation is only in causes of  
24 action that the Trustee independently uses his

---

102

1 judgment that he's not going to bring --

2 MR. KORTANEK: That's correct.

3 THE COURT: So does that hurt the  
4 creditors? And you're here as a creditor, not as  
5 a defendant.

6 MR. KORTANEK: Right.

7 THE COURT: Why does that hurt the  
8 creditors if the Trustee says, I'm not going to  
9 do it. Is it worth it, or I don't think it's  
10 worth it, or I don't want to spend my time on it,  
11 or I don't think it's a good enough cause of  
12 action to pursue to have somebody else who's  
13 interested in collecting money say, okay, I'll do  
14 it.

15 MR. KORTANEK: Whether --

16 THE COURT: Isn't that what we have  
17 here?

18 MR. KORTANEK: Well, no. Your  
19 Honor, the question is not whether it hurts  
20 creditors.

21 I was going to take Your Honor back  
22 to the STN case, which is out of the Second  
23 Circuit.

24 THE COURT: Which case?

103

1 MR. KORTANEK: STN.

2 THE COURT: Yeah.

3 MR. KORTANEK: It's a Second Circuit  
4 case, and it's a very important case. It's a  
5 1995 case.

6 The cite is 779 F. 2d 901. And STN  
7 and lot of cases that follow it articulated a  
8 standard for when a party seeks to obtain  
9 delegation of an estate cause of action.

10 First of all, when you think of the  
11 whole Bankruptcy Codes and what a Trustee or  
12 Debtor-in-possession has under 544, they have  
13 things that are given to the Trustee.  
14 Hypothetical creditor standing, without the  
15 baggage, let's say that comes with being an  
16 actual true creditor who would have to bring a  
17 fraudulent transfer claim.

18 I thought it was very interesting to  
19 hear questions and answers about potential cross  
20 claims or counterclaims. Because it will be  
21 especially awkward for someone like Royal to be  
22 standing in the shoes of a supposed fiduciary for  
23 the estate, which I think one has to accept  
24 someone bringing an estate cause of action, if

---

104

1 it's being delegated, not sold.

2 If it's being delegated, what comes  
3 with that is the fiduciary duties that an estate  
4 fiduciary would have, which I think they've  
5 acknowledged begrudgingly that they would have to  
6 file fee applications.

7 We appreciate that they have moved  
8 our direction, but also they have to be free of  
9 conflicts.

10 Take a look at 327(e), for example,  
11 Your Honor. That really -- you talk about the  
12 lowest point of a professional's lack of conflict  
13 as an example when an estate cause of action is  
14 going to be pursued, you can bring in a special  
15 litigation counsel.

16 But the most important thing  
17 articulated in 327(e) is that they cannot hold an  
18 interest or represent an interest.

19 THE COURT: So why isn't that an  
20 issue to be -- you heard that, in fact, if this,  
21 in fact, happens, stop me if I'm misstating it --  
22 you are -- they're going to come in with a motion  
23 for permission to do that.

24 MR. WOLFSON: Your Honor, that would

105

1 only happen in connection with the Paragraph 2  
2 claims if the Trustee's counsel, all of them,  
3 attempt to bail out of the case, and there's  
4 nobody else left representing the Trustee.

5 THE COURT: So --

6 MR. WOLFSON: As to right now, as  
7 the testimony indicated, it is the anticipation  
8 of the parties that the Trustee is going to bring  
9 all of the litigation. What, as Your Honor  
10 properly noted, Paragraph 7 is designed solely to  
11 say that, in the event the Trustee chooses not to  
12 bring a particular cause of action that Royal  
13 believes ought to be pursued, then, at our own  
14 cost and expense on behalf of the estate, we can  
15 do it.

16 The one exception that we know about  
17 today, and as far as we know the Trustee is going  
18 to be bringing all of the other actions, but the  
19 one exception we know about today at the request  
20 of the Trustee is the CDI, DDI litigation.

21 And --

22 THE COURT: All right.

23 MR. WOLFSON: That's the only one.

24 THE COURT: I don't want to waste

106

1 your time with something I've already decided.

2 I'm going to overrule your objection on  
3 delegation.

4 Move on to the other points.

5 MR. KORTANEK: Thank you, Your  
6 Honor.

7 Your Honor, we'll be moving for a  
8 stay pending appeal, because I think it's clearly  
9 something that the Third Circuit or the District  
10 Court will find important, and we shouldn't have  
11 our rights prejudiced.

12 Your Honor, --

13 THE COURT: What right is being  
14 prejudiced by the right not to be sued by Royal?

15 MR. KORTANEK: Not at all, Your  
16 Honor. But the right that's being prejudiced is  
17 when an estate fiduciary who's -- the exercise of  
18 his fiduciary duty to decide to settle the CDI's  
19 claim has not been challenged as an appropriate  
20 exercise of that duty.

21 Today, the Trustee, again, he  
22 iterated he thought that was a good business  
23 judgment as a Trustee and as a fiduciary. That  
24 right would now be given against a very -- the

---



107

1 very party that, by Royal's own choosing it, it  
2 sued us on the same claims in Tennessee.

3 We have counterclaimed in a five or  
4 seven-count complaint seeking from Royal all the  
5 damages that our clients have suffered, seeking  
6 doubling of those damages. You have the Trustee  
7 acknowledging that he has valid -- he believes he  
8 has valid claims against Royal.

9 So what you have is an inherent and  
10 irreconcilable conflict of interest that I've  
11 never seen in all the STN or Cybergenic-type  
12 cases.

13 So Your Honor, I want to be clear  
14 that the conflict issue is the remaining point  
15 for us and for the estate, and we think it's  
16 irreconcilable as far as Royal's interests are  
17 concerned.

18 Think about how the litigation will  
19 be prosecuted. There are hundreds --

20 THE COURT: I've given you my  
21 ruling.

22 MR. KORTANEK: Thank you, Your  
23 Honor.

24 Your Honor, I guess what I'm getting

108

1 into, we'll submit papers for motion for stay,  
2 and we'll do that in writing.

3 Your Honor, as to the --

4 THE COURT: Did you argue the 327(e)  
5 issue --

6 MR. KORTANEK: We did raise that  
7 section, Your Honor.

8 THE COURT: -- in your objection?

9 MR. KORTANEK: Yes. I raised it as  
10 a benchmark because, to me, it was important to  
11 think about how the Bankruptcy Code was written,  
12 that even where there's --

13 THE COURT: Counsel, you know your  
14 virtue of protecting the system is very  
15 impressive, but raising these things out of the  
16 dozens, perhaps hundreds of creditors, your  
17 virtue is -- I'm not going to question your  
18 virtue, but your motives are suspect.

19 MR. KORTANEK: That's fine, Your  
20 Honor. And in fairness, the same can be said for  
21 Royal and seeking the delegation only against us.

22 THE COURT: But Royal's putting up  
23 the bucks, too. And, you know, if you want to  
24 stall and do that, fine.

---

109

1                   The worse that happens is that  
2       somebody else will sue you. I mean, you know...

3                   MR. KORTANEK: Well, that's fine,  
4       Your Honor.

5                   THE COURT: You're being sued.  
6       You're a defendant.

7                   Defend the case. Don't waste a lot  
8       of time, effort, and money on side issues.

9                   Let's move onto your other  
10      arguments.

11                  MR. KORTANEK: Your Honor, the  
12      second point is a process. You have an agreement  
13      in front of you that it's interesting that they  
14      have decided, evidently in response to the  
15      objections, that they will now file these  
16      material side agreements under seal. But they  
17      haven't been filed yet.

18                  It's admitted that they are  
19      material, and they haven't been disclosed to Your  
20      Honor. I think that alone is cause --

21                  THE COURT: I'm not going to approve  
22      the agreement until I get them.

23                  MR. KORTANEK: I appreciate that,  
24      Your Honor. That's certainly an important

110

1 point --

2 THE COURT: You do understand that  
3 by -- if they filed them in open Court, at least  
4 their uncontroverted testimony is there being  
5 competitive disadvantage to which you -- or you  
6 have a claim in this case.

7 MR. KORTANEK: I understand.

8 THE COURT: I really don't want to  
9 do that. Do you?

10 MR. KORTANEK: I don't disagree with  
11 that, Your Honor. Again, it's a process. I  
12 think it's important.

13 THE COURT: All right.

14 MR. KORTANEK: Now, on the merits,  
15 Your Honor, I thought it was -- the one thing  
16 that really sticks out to me when you look at a  
17 half a billion dollar claim, that will be  
18 irrevocably allowed today if Your Honor were to  
19 grant the motion, the case is essentially over,  
20 and -- as to all other creditors are concerned.

21 Did you read -- rhetorical question.  
22 Did you really hear enough today to "end the case  
23 for other creditors"? Specifically the Trustee  
24 told Your Honor that -- what I think is the

---

111

1 biggest potential neutron bomb as to the claim,  
2 the contract-based claim back against the estate.

3 To me a 510(c) claim is a very, very  
4 important issue. And it has not been explored as  
5 to any potential 510(c) predicated on the aiding  
6 and abetting claim that was only refiled a few  
7 months ago by the Trustee.

8 So it looks to us, and I think the  
9 record shows that since that complaint was filed  
10 in April, very little has actually been done. We  
11 don't -- I didn't hear any clear evidence that  
12 there were actual depositions or examinations  
13 taken in that litigation.

14 I thought the cross by the other  
15 objecting counsel was also important, that there  
16 was no expert retained at any time to look at the  
17 aiding and abetting claims, and other claims that  
18 could be leverage -- leverage under a 510(c).

19 Maybe not a meritorious one, but  
20 certainly having a lot of value to other  
21 creditors of the estate.

22 Because if you subordinate just a  
23 part of this claim, given what's been represented  
24 about non-Royal creditors, that's of enormous

112

1 impact to other creditors. Your Honor, our  
2 litigation in Tennessee will, in fact, be  
3 pursuing claims against Royal on many of those  
4 theories.

5 And it will be interesting, Your  
6 Honor, if the Tennessee District Court will be  
7 hearing those things. It's going to go to trial  
8 at some point, perhaps a year from now.

9 And only time will tell whether, you  
10 know, who proves right in terms of what Your  
11 Honor is being asked to do today.

12 But those issues are engaged, and I  
13 think it's a fair statement, just as Your Honor  
14 was convinced that the Trustee should not have  
15 approved the settlement with our client, based on  
16 all the evidence that Royal brought up from the  
17 Tennessee litigation without our participation.

18 Well, Your Honor, the same can be  
19 said going the other direction. So we didn't  
20 bring that show to Your Honor, because quite  
21 frankly, they didn't -- we didn't have the six or  
22 seven weeks that Royal had when the Trustee filed  
23 the motion as to our settlement.

24 So you really have a remarkable

113

1 mirror image as to what Royal knew, what it  
2 didn't know. And is there any basis for a  
3 510(c)?

4 That ought to, with all respect,  
5 have some seed of doubt that I think doesn't meet  
6 the lowest range.

7 THE COURT: Well, seed of doubt, I  
8 mean, you know, yeah, I've got seeds of doubt all  
9 over the place. But he doesn't have to make a --  
10 very much of a showing. That's my point.

11 I mean, is the burden -- does he  
12 have to get rid of all my seeds of doubt?

13 MR. KORTANEK: Your Honor, that's a  
14 poorly chosen phrase.

15 THE COURT: But I mean --

16 MR. KORTANEK: Your Honor --

17 THE COURT: It's not my judgment,  
18 would I do this? It's his judgment measured by  
19 the lowest end of the spectrum of reasonableness,  
20 isn't it?

21 MR. KORTANEK: Well, that's what  
22 we've always thought, Your Honor. And in fact,  
23 you know, what Your Honor saw on the settlement  
24 for our claim, although I was excluded from the

114

1 courtroom, was an awful lot of evidence with no  
2 testimony from Royal. Documents that were taken  
3 out of context.

4 Where you are today is at least  
5 we've had live testimony. And through that  
6 testimony, I think the most important tool in  
7 dealing with the Royal claim has been that that  
8 stone has been left completely unturned.

9 That's more than a seed of doubt. I  
10 don't think that passes muster as even satisfying  
11 the lowest range of reasonableness under the  
12 standard that Your Honor is supposed to apply.

13 Because even a partial  
14 subordination -- if we're only talking about 10  
15 million, or 20, or 30 in other claims, a partial  
16 subordination of a half a billion dollar claim of  
17 a few million -- few million dollars would mean  
18 that those dollars go to other creditors first,  
19 and then the rest can go to Royal.

20 As I understand the economics of  
21 this deal, even leaving the three million on the  
22 table, Royal's taking back 90 percent of it. I  
23 may be missing something, but that's how I see  
24 it.

---



115

1 THE COURT: Well, if there's -- I  
2 don't see that at all. I think it's 90 percent  
3 of what's left as long as it's not -- and it's  
4 only up to a million nine, and then they get --

5 MR. KORTANEK: I can be corrected on  
6 that. I know they have the million nine  
7 superpriority, but the three million typical bank  
8 deal.

9 THE COURT: Let me ask you, counsel:  
10 You seem to think that -- you were very concerned  
11 in your objection about the timing of this thing,  
12 yet, you haven't honored that today. And at  
13 least two creditors, maybe more if they file  
14 their statements, as they should have already  
15 done are objecting.

16 Why do you think that is?

17 MR. KORTANEK: Well, I asked the  
18 witness, Your Honor, candidly. I asked the  
19 witness how much of a factor the time was to the  
20 Trustee.

21 And I was going to get to that.  
22 It's a tertiary argument.

23 I think it's clear from the motion,  
24 Your Honor, that a very significant reason for

---

116

1 filing it when they're filing it is they need a  
2 war chest.

3 THE COURT: You already heard, but  
4 he also said he just filed -- he's already filed  
5 more than 60 lawsuits.

6 MR. KORTANEK: That is right, Your  
7 Honor.

8 THE COURT: And that there's money  
9 in the estate.

10 MR. KORTANEK: That's right. I'm  
11 not making that my first argument.

12 I still think the timing is suspect.  
13 I don't think it's an issue.

14 THE COURT: But I'm not suspect of  
15 the timing. I understand -- I get the sense that  
16 you felt that things would be different and more  
17 people would object if there was more time.

18 And I mean, I haven't seen any  
19 creditor file a motion asking for more time.  
20 I've only seen two out of the hundreds of  
21 creditors even taking the interest to show up.

22 Now, is there something misleading  
23 about the notice?

24 MR. KORTANEK: For -- Your Honor,

117

1 for a settlement that's been negotiated for six  
2 months, for a settlement that the story of the  
3 case will tell, it has virtually changed the case  
4 in a remote fashion.

5 THE COURT: My view is somewhat  
6 different than yours. I see the Trustee spending  
7 a very significant amount of time and energy  
8 duking it out, very preliminary grounds with  
9 Royal with no focus on other things.

10 And you may not have seen it all,  
11 but it's -- I mean, it's been a war of attrition  
12 on both sides.

13 And I understand why the Trustee  
14 would like to get on with other things,  
15 particularly, and I have no reason to disbelieve  
16 them. If their evaluation of the litigation was  
17 what he said it was, I don't know why I should  
18 disbelieve that.

19 MR. KORTANEK: Well --

20 THE COURT: I mean, I'm concerned,  
21 510(c), that maybe he could have squeezed a  
22 little more out of Royal. You know, that's his  
23 judgment, not yours.

24 MR. KORTANEK: Well, that's right,

118

1 Your Honor. Although, respectfully, I don't  
2 think he exercised any -- I think that's what the  
3 evidence shows on that point, because he  
4 didn't -- he did not analyze if he were -- had  
5 any chance of success on the aiding and abetting  
6 claims as he said, whether that would dovetail  
7 into any 510(c). So I don't think that's there.

8 And Your Honor, that's essentially  
9 our argument, and we'll sit down.

10 Thank you.

11 THE COURT: Thank you.

12 MR. STERN: Your Honor, he  
13 articulated the objections. I won't repeat them.

14 I think what really -- what really  
15 stood out in the testimony of the Trustee and  
16 what bothered me most about the settlement is the  
17 fact that it was clear that it wasn't -- was a  
18 war of attrition.

19 That's something that motivated the  
20 trust at the -- to do the settlement. We all  
21 understand that.

22 THE COURT: It's part of litigation.  
23 It's part of litigation.

24 MR. STERN: I question why the trust

1 didn't seek out other alternatives. If the  
2 Trustee thought it was too costly, too expensive  
3 to handle it, didn't have the manpower or  
4 whatever, I would say that prudence dictates the  
5 minimum level that you see, if there's any other  
6 alternatives.

7 The Trustee clearly testified that  
8 he didn't consider offering this case to another  
9 counsel who might be competent, who might be able  
10 to handle it, who might have the capacity and the  
11 resources to duke it out and benefit the estate.

12 What we've done here is it's a  
13 capitulation to the 800-pound gorilla, with all  
14 due respect, because they had the resources to  
15 beat the Trustee based on their ability to fund  
16 it. And it was clear through the Trustee's own  
17 testimony that, you know, he's called it a day.

18 Now, that may have been prudent for,  
19 on his standpoint, to say, hey, you know, I  
20 really have had enough of this litigation, but  
21 from the standpoint, the bigger picture, and I  
22 believe, and Your Honor, I represent many of the  
23 schools here on 93 that I filed, and I will file  
24 the statement, there is no litigation pending.

---

120

1                   We are -- we represent the unsecured  
2     creditors. We have several million dollars in  
3     claims.

4                   I've been following the bankruptcy  
5     since the Chapter 11 was filed. I have not taken  
6     a proactive stance, because there's nothing that  
7     had to be done.

8                   But, ultimately, we are, at the end  
9     of the day with this big claim against Royal, and  
10    there's really no benefit to the estate. And  
11    then Royal now calls the shots.

12                  I think it is -- and I know Your  
13    Honor had ruled. I'll just add one more point.

14                  If there was some oversight to the  
15    delegation aspect that I feel more comfortable,  
16    but what we have, in effect, is Royal's ability  
17    now to sue whoever they want, when they want, and  
18    to use the Bankruptcy Court as a forum for that.

19                  Now, because they're 90 percent of  
20    the unsecured claims, they have the most benefit  
21    available. I think the Court should have some  
22    oversight over that.

23                  I think that it should be noticed to  
24    all the unsecured creditors that the Trustee has

---

121

1    been presented a claim to pursue, and the Trustee  
2    has decided to delegate that. And we should  
3    know, as unsecured creditors, what the terms and  
4    conditions of the agreement are.

5                    You know, it could be that Royal  
6    spends millions of dollars in that claim  
7    defending, and we have another administrative  
8    claim that we have to deal with. There are no  
9    checks and balances.

10                   There is a complete delegation  
11   responsibility. I believe that Royal's counsel  
12   said that, to the extent that there's any  
13   obligation to seek Court approval, it only  
14   applies to Paragraph 2.

15                   I would ask Your Honor to consider  
16   applying those same provisions to Paragraphs 7  
17   and 11, which would then give the creditors a  
18   fighting chance of at least knowing what's going  
19   on.

20                   Thank you, Your Honor.

21                   THE COURT: Thank you.

22   Mr. McMichael.

23                   MR. McMICHAEL: Your Honor, as a  
24   matter of basic litigation strategy, I think it's

---

122

1 obvious why we cannot put on the open -- in the  
2 open record the amount that we have agreed to  
3 with Royal, by which we can give up Royal's  
4 claim, knowing that would be a significant  
5 litigation disadvantage.

6 And we have those agreement letters  
7 here, and I have prepared an envelope to file  
8 them under seal, and would request that the Court  
9 permit me to file them under seal for the Court's  
10 inspection.

11 THE COURT: I will take them, but I  
12 don't recall off hand whether there's a  
13 requirement that you file a motion under the  
14 local rules.

15 THE CLERK: Yes.

16 THE COURT: Give them to me. File  
17 your motion tomorrow.

18 MR. McMICHAEL: Yes, sir. These  
19 letters would be addenda to Exhibit A to our  
20 settlement agreement, and are part of it.

21 And they relate to Paragraph 6 and  
22 to Paragraph 8. Let me just point out the effect  
23 of them, though. It's less than meets the eye.

24 In Paragraph 6, if we reach a

---



123

1 certain threshold of either recovery of  
2 settlement of the claims against Pepper, we, the  
3 Trustee, can bind Royal to it, so that Royal's  
4 claims are settled at the same time. If we  
5 don't, it doesn't mean we can't litigate with  
6 Pepper, and achieve whatever recovery we can  
7 achieve.

8 It doesn't mean we can't settle. We  
9 can still settle.

10 We just couldn't settle by giving up  
11 Royal's claim. That's all that really amounts  
12 to.

13 Paragraph 8, same thing. We can  
14 object to admin claims in the Chapter 11, and  
15 have those allowed or disallowed as the Court  
16 sees fit, or we can settle them.

17 And what Paragraph 8 says simply is  
18 if we settle them for a certain amount or less,  
19 Royal will give up its claim. If Royal doesn't  
20 give up its claim, we have the right to object to  
21 the claim as well as any other claim. Nothing is  
22 given up there.

23 So I would submit that these are --  
24 it is important for these things to not be on the

124

1 record at the same time. They're not as  
2 important as our adversaries would make them out  
3 to be.

4 By the way, Your Honor, I am -- and  
5 we're happy to file a motion tomorrow morning.  
6 I'm advised by my local counsel that under Rule  
7 9013, we can move orally in Court for permission  
8 to file a document under seal.

9 THE COURT: You may be able to, but  
10 I don't --

11 MR. McMICHAEL: That's fine.

12 THE COURT: Oral motions are very  
13 hard for people to read on the record.

14 So file a motion, and I will deal  
15 with the motion.

16 But I -- you know, it's one thing to  
17 have a signed agreement with good litigation  
18 strategy protection, but I don't think that the  
19 same applies to the Court entering orders.

20 MR. McMICHAEL: Very well.

21 THE COURT: Let me ask you a  
22 question, counsel.

23 MR. McMICHAEL: Yes, sir.

24 THE COURT: The basis for your

125

1 expedited motion was that this was the last  
2 omnibus hearing before the expiration of the  
3 two-year statute of limitations. But as I sit  
4 here and listen to what I've been told, so what?

5 I mean, I didn't hear that there  
6 were cases that couldn't be filed because the  
7 two-year statute of limitations was about to  
8 expire, nor have I heard anything today that  
9 tells me that.

10 MR. McMICHAEL: Your Honor, the  
11 Trustee wasn't really asked that question. And I  
12 didn't address it in my proffer, not thinking it  
13 was an issue.

14 But the answer is this: The Trustee  
15 has a broad range of claims that it believes  
16 should be brought against many people. It has --  
17 the Trustee has some money in the estate, but not  
18 nearly enough to litigate those claims.

19 THE COURT: But not enough to  
20 litigate them, but certainly to bring them?

21 MR. McMICHAEL: Yes.

22 THE COURT: I mean, the concern that  
23 I have, I'm going to be very frank with you, is I  
24 ruled on the delegation issue. I'm feeling a

126

1 little uncomfortable about it, I must tell you.

2 And I'm not sure that -- you know,  
3 sometimes you've got to be careful what you wish  
4 for.

5 MR. McMICHAEL: Mm-hmm.

6 THE COURT: If I'm wrong, and if  
7 you're wrong, you're going to spend the next year  
8 fighting the delegation battle, rather than  
9 dealing with the rest of the case.

10 MR. McMICHAEL: Right. We can --

11 THE COURT: I am --

12 MR. McMICHAEL: I'm sorry.

13 THE COURT: I'm wondering if you  
14 guys want to think about whether you want to talk  
15 amongst yourselves. I understand everybody's all  
16 excited behind you, but --

17 MR. McMICHAEL: That happens.

18 THE COURT: I understand. But think  
19 about whether maybe you want to try to, and maybe  
20 Royal ought to, too, because they don't want to  
21 fight this battle and find out a year from now  
22 that I was wrong, and you were wrong to ask me,  
23 to give me the opportunity to be wrong.

24 Because that's just another waste of

127

1 everybody's time and effort. And maybe you ought  
2 to think about that, because I have no reason to  
3 disbelieve that they're going to ask for a stay.

4 They're probably not going to get it  
5 from me, but they may well get it from someone  
6 else in this building. And whether you want to  
7 fight that battle, and whether you want to just  
8 try to accommodate what their concerns are.

9 And I'm particularly concerned about  
10 the potential types of disinterested issues that  
11 you end up with, and the analogy of the 327(e).

12 And the disinterested standard is  
13 one. I mean, I'm going to review this any way.

14 I'm not going to decide this today.  
15 But whether you really want to just put this on  
16 for perhaps the next time I'm here, and consider  
17 whether you want to try to craft some, perhaps  
18 insignificant in the real world, modifications in  
19 the agreement, but ones that might accommodate  
20 and deal with those particular issues.

21 MR. McMICHAEL: I'll do it.

22 MR. ASTIN: Your Honor, before you  
23 rule --

24 THE COURT: I'm not going to rule.

128

1 MR. ASTIN: Just a moment with  
2 Mr. McMichael?

3 MR. McMICHAEL: He wants to make  
4 sure I don't say anything really stupid.

5 THE COURT: He wants to tell you  
6 what they've been negotiating while you've been  
7 talking.

8 (Following a discussion held off the  
9 record:)

10 MR. McMICHAEL: No. Your Honor's,  
11 suggestion that we think about this is exactly  
12 the right suggestion.

13 The good news is we already did  
14 that, and we did it while other things were  
15 happening in the courtroom. And we can solve the  
16 problem right here.

17 The only case as to which there is a  
18 current issue concerning delegating to Royal the  
19 ability to bring on behalf of the estate is CDI,  
20 DDI, Mr. Kortanek's client. The Trustee will  
21 simply bring that case.

22 It won't be an issue. The reason  
23 that we were doing it this way was because we  
24 felt since we had tried to settle the case, and

129

1 the Court has overruled us on that, and we accept  
2 the Court's ruling. And that's the basis for  
3 which we now go forward.

4 That is our foundation. We thought  
5 that under those circumstances, it might be less  
6 awkward for Royal to do it, but it's not really a  
7 significant matter. And we're happy to do it.

8 So there will be no other  
9 delegation, unless the Trustee decides not to  
10 bring a claim, or Royal wants to bring it. And  
11 the Court can take that up when, and if, it  
12 happens.

13 THE COURT: But that's what I  
14 thought it was, but it's not. Apparently,  
15 Paragraph 2 is different than Paragraph 7.

16 MR. McMICHAEL: Well, Paragraph 2  
17 isn't going to happen unless the Court agrees to  
18 it.

19 THE COURT: But what I'm  
20 suggesting -- it's late. We are all tired.

21 What I'm suggesting is take a look  
22 and see whether you can make everybody happy and  
23 accomplish what you want. And take a few days,  
24 if necessary, talk to the other side, look at

130

1 this whole new world.

2 You guys are sitting on the same  
3 side of the table. Maybe you can sit on the same  
4 side of the table with them.

5 I will rule if I have to. What I'd  
6 like you to do is submit to me a black lined with  
7 whatever you decide you want to do that modifies  
8 the term sheet that's there. I think in spite of  
9 the fact that I think everybody's acting in good  
10 faith, your agreement says the term sheet's got  
11 to be signed. I think it should be signed.

12 MR. McMICHAEL: The agreement?

13 THE COURT: The modifications don't  
14 have to be in writing. I'd feel better if I'm  
15 approving something that at least both sides have  
16 signed off on.

17 Take a few days. I'm going to take  
18 this under advisement. I'm going to await a  
19 black lined from you with whatever amendments you  
20 want, and then I will rule if it's necessary.

21 If you resolve the issues, or if you  
22 think you've accommodated things, just black line  
23 it. I'll look at them, and I'll give you my  
24 ruling.

---



131

1 I will tell you that I'm not  
2 troubled by the 510(c) issue. I think that I'm  
3 satisfied with the economics of the transaction.

4 I'm prepared to approve it on the  
5 basis that it does not, or it reaches at least  
6 the lowest -- what's the exact words? I forget.

7 I don't want to misstate this. The  
8 lowest end of the spectrum of reasonableness, I  
9 think you've satisfied me on that. It's these  
10 other issues that are raised, and that raise real  
11 issues.

12 Now, I think I'm right on the  
13 delegation issue, but you know, I've been  
14 reversed before. I know that may be shocking to  
15 you.

16 But I don't want to put you through  
17 another year, a year and a half of unnecessary  
18 litigation if a couple of corrective points  
19 that -- and I'm not trying to interject myself  
20 into the Royal litigation. I mean, if you can't  
21 resolve it, if there's no change to the  
22 agreement, just submit a signed agreement, and I  
23 will rule.

24 Okay.

132

1 MR. McMICHAEL: Your Honor, that's  
2 fine. And we will be guided by what the Court  
3 wants, and we'll do that.

4 I have two observations, though,  
5 that -- just so I am accurately communicating  
6 with the Court on these subjects.

7 The first is the statute of  
8 limitations is not an unimportant date for us,  
9 because it effects Mr. Stanziale's judgment as  
10 to --

11 THE COURT: So when is it? What day  
12 is it?

13 MR. McMICHAEL: It's November 3rd.

14 THE COURT: Oh, that's light years  
15 away.

16 MR. McMICHAEL: It's next week.

17 THE COURT: Well, is that before or  
18 after the parade in Boston?

19 MR. McMICHAEL: It will be after the  
20 parade in Boston.

21 THE COURT: You can skip the game  
22 and do it tonight. I don't really care.

23 Get me something.

24 MR. McMICHAEL: We will. We will.

133

1 THE COURT: You will have a ruling.

2 You get me materials, you'll have a ruling.

3 What's the 3rd?

4 MR. McMICHAEL: The 3rd is next

5 Wednesday.

6 THE COURT: Okay.

7 MR. McMICHAEL: Okay. We will.

8 THE COURT: I'm here all day

9 tomorrow if you want to submit something

10 tomorrow.

11 MR. McMICHAEL: We will.

12 THE COURT: Fine.

13 MR. McMICHAEL: We will.

14 My second question is -- I think

15 Your Honor has answered it -- we don't need to

16 have another hearing. We need to submit --

17 THE COURT: Not unless you think,

18 after due consideration, that you need another

19 hearing.

20 MR. McMICHAEL: Okay.

21 THE COURT: You know, the

22 probability of you getting another hearing

23 between now and the 3rd is low. If you think

24 there's a need for another hearing, then you will

134

1 tell me.

2 MR. McMICHAEL: We don't think  
3 there's need for another hearing. In fact, we  
4 prefer there not to be one for wanting to get  
5 this resolved before the 3rd for obvious reasons.

6 So we know we have this deal that  
7 will -- in place before we dive head first into a  
8 large pool of litigation.

9 THE COURT: Fine.

10 MR. McMICHAEL: That is all right.  
11 I think that's all we have today on this issue.

12 THE COURT: That takes care of the  
13 matter. We took -- the small matter, we took out  
14 of order.

15 You gentlemen are excused if you  
16 want to. We have several other matters. Don't  
17 run away.

18 MR. STANZIALE: May I make it clear  
19 to the Court that, as Trustee, I am going to  
20 pursue the action against CDI, DDI. I'm not  
21 going to delegate that right to Royal.

22 Royal understands that, and Royal  
23 agrees with that.

24 THE COURT: Well, put it in the

135

1 agreement.

2 MR. STANZIALE: Okay. I just wanted  
3 the Court to understand.

4 THE COURT: Fine. I appreciate  
5 that, and I understand that.

6 All right. I'm going to exercise my  
7 extensive powers and defer -- there are no  
8 objections, is that true, to the fees anymore?  
9 Although there was a continuance to give Royal an  
10 opportunity to get further information.

11 MR. ASTIN: That's correct, Your  
12 Honor. Three --

13 THE COURT: Do you have orders for  
14 me?

15 MR. ASTIN: I have orders.

16 THE COURT: Does anybody want to be  
17 heard on those fee applications in opposition to  
18 them? Fine.

19 Give me your orders.

20 MR. WOLFSON: Your Honor, we  
21 resolved the fee application and have agreed just  
22 to a 20-percent hold back. And on that basis --

23 MR. ASTIN: Your Honor, I have 10  
24 seconds on what we've agreed to.

136

1 THE COURT: Go ahead.

2 MR. ASTIN: We have all made  
3 reductions by agreement with the U.S. Trustee or  
4 otherwise. These orders will all reflect that.

5 We've agreed that we go with a  
6 20-percent hold back on this application.

7 THE COURT: Is that in the order,  
8 too?

9 MR. ASTIN: That's in the order.  
10 Then we're going to file at a hundred percent  
11 several months.

12 THE COURT: All right.

13 MR. ASTIN: We're going to also put  
14 another motion on, so that going forward  
15 beginning about November, we'll start going with  
16 an 80-20 hold back, if Your Honor signed that  
17 order.

18 That's all I have.

19 THE COURT: Very well. Okay.

20 So five is under advisement.

21 Just put them over there with the  
22 fees. We'll deal with them tomorrow.

23 The motion to prove the settlement,  
24 MBIA and Wells Fargo.

137

1 MR. ASTIN: There are no objections,  
2 Your Honor.

3 MS. AUERBACH: We have a slightly  
4 revised order.

5 THE COURT: Give me the order. I'll  
6 take care of it tomorrow.

7 What's that?

8 MR. ASTIN: Your Honor, we have the  
9 motion to quash, which Ms. Auerbach is handling,  
10 which is not resolved.

11 THE COURT: Okay. Let me just put  
12 these things aside.

13 MR. WINTER: Your Honor, good  
14 evening. Chris Winter with Duane Morris.

15 Your Honor, I'm here for McGladrey &  
16 Pullen and RSM McGladrey, Inc., and I'd like to  
17 introduce the Court to Veronica Rendon of Thelen,  
18 Reid & Priest.

19 We have filed papers for her  
20 admission pro hac vice. I'd like to supplement  
21 that now with an oral motion.

22 THE COURT: Go ahead. Welcome,  
23 Ms. Rendon.

24 MS. RENDON: Thank you, Your Honor.

138

1 And I'll try to go as quickly as I can in light  
2 of the hour that we're at.

3 THE COURT: We've got an hour and 18  
4 minutes.

5 MS. RENDON: Okay.

6 THE COURT: An hour and 38 minutes.  
7 Security people might not think so, though.

8 MS. RENDON: That's fine.

9 MR. WOLFSON: Do you have tickets to  
10 game five or not?

11 THE COURT: Actually, I have tickets  
12 to game six, and I'm prepared to -- they're  
13 available for a small premium now.

14 MS. RENDON: I'm guessing this is  
15 not the right time to say I'm from New York, and  
16 I'm a Yankees' fan. So I won't.

17 THE COURT: We all have our crosses.  
18 I've been carrying one around for 60 years.

19 MS. RENDON: Good luck. Actually  
20 I'm rooting for the Sox.

21 I'm here on behalf of McGladrey &  
22 Pullen and RSM McGladrey's motion, emergency  
23 motion to quash a subpoena that was served by  
24 Royal on the bankruptcy Trustee, in which Royal



139

1 is seeking documents.

2 I'm just going to call them  
3 McGladrey, and have that term cover both  
4 McGladrey & Pullen, and RSM McGladrey, Inc. just  
5 for the Court's convenience.

6 But we're here to quash the subpoena  
7 that Royal served on the Bankruptcy Trustee in  
8 which Royal is seeking the documents that  
9 McGladrey made available to its Trustee earlier  
10 this year.

11 And the basis for our objection  
12 is -- there are a number of bases for our  
13 objection. The first is that the subpoena was  
14 issued in a procedurally improper manner.

15 It was issued with too short notice.  
16 There was less than 48 hours' notice given for  
17 the subpoena.

18 THE COURT: All right. So let's --  
19 if I was prepared to deny it on that, they'd  
20 issue a new one. Let's not spend a lot of time.

21 MS. RENDON: It was not done on  
22 notice. But most importantly, Royal does not  
23 have standing to have issued the subpoenas.

24 The basis for the issuance,

140

1 according to Royal's paper and the Trustee's  
2 submission, is the settlement that the Court is  
3 considering today. Obviously, that settlement  
4 was not in place when the subpoena was issued,  
5 and it's still not in place.

6 So to the extent that the mechanism  
7 from which Royal is standing to have issued the  
8 subpoena, Royal doesn't have standing to have  
9 issued that subpoena.

10 Secondly, the subpoena violates a  
11 confidentiality agreement that McGladrey entered  
12 into with the Trustee. And I'll give you some  
13 additional factual background on that.

14 But let me just outline quickly  
15 that -- all the three bases for our objection.  
16 And then our most substantive objection, going  
17 past procedural issues, I think dovetails very  
18 much with the Court's express concerns or some  
19 concerns that the Court has about delegation to  
20 Royal.

21 I think it's clear, and again, I'll  
22 give you some factual background to support the  
23 assertion I'm about to make, that the subpoena  
24 issued by Royal is really an attempt to obtain

---

141

1 improper pre-claim discovery against McGladrey,  
2 relating much more to a civil lawsuit that Royal  
3 is contemplating against McGladrey, having  
4 nothing to do with any type of action that the  
5 estate would like to bring against McGladrey.

6 And let me explain that a little bit  
7 further by giving you a factual background here  
8 about the circumstances surrounding the issuance  
9 of the subpoena.

10 Back in January of 2004, the Trustee  
11 approached McGladrey asking for our documents.  
12 McGladrey had acted as one of the accountants and  
13 auditors for Student Finance Corporation for a  
14 number of years.

15 Given the Trustee's broad 2004  
16 powers --

17 THE COURT: I'm sorry. I was trying  
18 to ask parties over there to quiet down, so that  
19 I could hear you better.

20 MS. RENDON: I have enough children,  
21 I'm able to tune that out.

22 But thank you.

23 THE COURT: But my children are  
24 grown up. I'm not as used to it as you, perhaps.

1 MS. RENDON: Okay. Given the  
2 Trustee's broad 2004 powers and understanding  
3 legitimacy of the Trustee's request to see our  
4 documents, we were agreeable back in January 2004  
5 to providing our documents to the Trustee. We  
6 only placed one condition upon providing our  
7 documents to the Trustee, and that was that we  
8 wanted to protect against third parties being  
9 able to go directly to the Trustee to seek our  
10 documents, instead of those same third parties  
11 coming to McGladrey & Pullen to seek those  
12 documents.

13 The reason why we had that type of  
14 concern back in January of 2004 is we were aware  
15 at the time of the number of civil litigations  
16 that were pending that involved Student Finance  
17 Corp., including the Royal and MBIA litigation  
18 that was pending in which Your Honor well knows  
19 at this point involves big numbers, over \$500  
20 million.

21 And because we were concerned that  
22 Royal or MBIA might try to circumvent coming to  
23 McGladrey to seek our documents and may go right  
24 to the Trustee. We asked the Trustee to enter

1 into a confidentiality agreement with McGladrey,  
2 in which we would protect against and ensure that  
3 the Trustee would provide McGladrey with notice,  
4 and an opportunity to intervene and object if a  
5 third party were, in fact, to come to the Trustee  
6 and seek our documents from the Trustee as  
7 compared to coming to McGladrey directly.

8 We explained our concerns to the  
9 Trustee, and back in February, on February 6th,  
10 2004, the Trustee entered into a confidentiality  
11 agreement with McGladrey to protect against  
12 third-party access to our documents without us  
13 having notice and an opportunity to intervene.

14 And Your Honor has a copy of that  
15 confidentiality agreement. It was attached as  
16 Exhibit 2 to the affidavit of Richard Swanson,  
17 which was submitted in support of our motion to  
18 quash.

19 The clear purpose of the agreement  
20 was to provide McGladrey with notice and an  
21 opportunity to respond to any third-party request  
22 for our documents. And what Your Honor will see,  
23 if you review that agreement, is that if, in  
24 fact, a third party made a formal request for our

---

144

1 documents through notice motion or a subpoena to  
2 the Trustee, the Trustee agreed to provide  
3 McGladrey with notice of that subpoena and an  
4 opportunity to object, to intervene and object.

5 THE COURT: Which is why you're here  
6 today.

7 MS. RENDON: That's right.

8 If, on the other hand, a third party  
9 came to the Trustee on an informal a verbal  
10 basis, and requested our documents, the Trustee  
11 agreed to provide McGladrey with notice of that  
12 informal request, and agree that if McGladrey  
13 requested that the Trustee go back to a third  
14 party and ask that that request for documents be  
15 made formal and be put in a formal written  
16 notice, so that, again, McGladrey would have the  
17 opportunity to intervene and object.

18 In entering into the confidentiality  
19 agreement, the Trustee argued at this time that  
20 there were too many limits being placed on  
21 counsel's ability to utilize the McGladrey  
22 documents, either in deposition or in Court  
23 submissions.

24 So we added a paragraph into the

145

1 agreement confirming the Trustee counsel's right  
2 to use our documents for those types of purposes.  
3 And it's that paragraph that you'll see cited in  
4 Royal's and the Trustee's opposition to our  
5 motion to quash.

6               However, the manner in which they're  
7 citing that paragraph is completely out of  
8 context. And tellingly, the way that they're  
9 citing that paragraph, it leaves out the last  
10 sentence of that paragraph, which again --

11               THE COURT: Which paragraph is it?

12               MS. RENDON: It is the second, Your  
13 Honor. It's the last large paragraph on the  
14 second page.

15               It should be -- it's the second --  
16 excuse me, the second substantive paragraph on  
17 the second page of the letter agreement starting,  
18 It should be noted.

19               THE COURT: It should be noted.

20               MS. RENDON: There it says that it  
21 should be noted that in making this proposal, we  
22 understand that the Trustee wishes to use the RSM  
23 documents for the benefit of the estate without  
24 limitation, and advanced notice is not requested.

146

1 By that I read for such use, thus,  
2 we do not propose limiting the Trustee's right by  
3 using the RSM documents as documents -- as  
4 attachments to Court submissions or for  
5 disclosure to the estate. Retained professionals  
6 agree to be bound by this letter or any other  
7 purpose that the Trustee determines would benefit  
8 the interest to the estate.

9 And counsel for the Trustee and  
10 Royal highlights that last clause of the  
11 sentence.

12 However, in citing this paragraph to  
13 Your Honor, they leave out the last sentence,  
14 which really articulates the purpose that we  
15 entered into the confidentiality agreement. And  
16 that sentence says, All we are seeking is  
17 protection against disclosure to third parties in  
18 the circumstances outlined in the third and  
19 fourth paragraph above without our awareness and  
20 our opportunity to respond.

21 Clearly, the intent of the agreement  
22 was to provide McGladrey with a notice and an  
23 opportunity to object and respond to any  
24 third-party request for our documents that are in



1 the Trustee's possession.

2 Believing that we would have that  
3 opportunity, on February 10th, 2004, McGladrey  
4 made the documents available to the Trustee. And  
5 we did so, again, a second time on October 1st of  
6 2004, after the Trustee agreed to be bound again  
7 by our confidentiality agreement when they --  
8 when they wished to review McGladrey's documents  
9 for a second time.

10 On September -- on September 15th,  
11 2004, the Trustee notified us that Royal had  
12 verbally requested access to our documents that  
13 were in the Trustee's possession. Knowing that  
14 Royal had just had a motion for summary judgment  
15 or motions for summary judgment granted against  
16 it in the MBIA civil litigation, and knowing that  
17 that may well result in an excess of a \$500  
18 million civil liability for Royal, and not  
19 understanding any legitimate purpose for Royal to  
20 be seeking our documents, we told the Trustee  
21 that we objected to Royal's request.

22 And pursuant to our agreement with  
23 the Trustee, we asked the Trustee to go back to  
24 Royal and have Royal make a formal written

148

1 request for our documents. The express purpose  
2 being so that we could intervene and object.

3 On September 22nd, pursuant to our  
4 request, Ms. Auerbach, counsel for the Trustee  
5 wrote to Royal, and made that request, that Royal  
6 put its request for our documents into -- make  
7 it -- put it into a formal written request.

8 At that time, Ms. Auerbach clearly  
9 understood that McGladrey planned on objecting to  
10 Royal's request for our documents. We did not  
11 hear anything further after September 22nd until  
12 October 13th.

13 On that day at 6:40 p.m. in the  
14 evening, we received a subpoena from Royal. I  
15 should say it's the Royal subpoena that was  
16 addressed to the Trustee, and the Trustee  
17 provided it to us at 6:40 p.m. on the night of  
18 October 13th.

19 It requested production of  
20 McGladrey' documents in the Trustee's possession.  
21 It requested that the production of those  
22 documents occur at 10 o'clock a.m. that -- the  
23 following Friday, October 15th, less than 48  
24 hours later.

1                   Clearly, the manner in which the  
2 subpoena was issued was designed to craft  
3 McGladrey's ability to intervene and object to  
4 the subpoena, notwithstanding the existing  
5 confidentiality agreement, and notwithstanding  
6 the fact that they were well aware of the  
7 existence of the confidentiality agreement.

8                   It was explained to us much earlier  
9 that Ms. Auerbach -- Royal had been provided with  
10 our confidentiality agreement and that they  
11 understood the terms.

12                   Still being at my desk at 6:40 at  
13 night, because that's just life in New York, I  
14 responded to Ms. Auerbach's Email, and the  
15 subpoena from Royal. And I notified Ms. Auerbach  
16 by Email that we plan on objecting to the Royal  
17 subpoena, because it was procedurally improper,  
18 because Royal lacks standing to issue the  
19 subpoena, and because we believed it was an  
20 improper attempt to obtain pre-claimed discovery  
21 for a civil litigation that Royal may wish to  
22 pursue against McGladrey some day.

23                   THE COURT: Is there -- there is no  
24 litigation pending between the estate and

150

1 McGladrey, is there?

2 MS. RENDON: No. In fact, I'll get  
3 to that.

4 It's our understanding that the  
5 estate, at least the estate represented by  
6 Ms. Auerbach's firm, has no, absolutely no  
7 intention of bringing a lawsuit against  
8 McGladrey. And I think I understand if the  
9 estate were to attempt to do that, they would  
10 face insuperable in pari delicto questions in  
11 trying to make that type of claim.

12 But let me get to that in just a  
13 moment. If that's in pari delicto, when I wrote  
14 back to Ms. Auerbach, the note of October 19th, I  
15 asked her in my Email to please confirm  
16 consistent with the confidentiality agreement  
17 that the Trustee would not produce our documents  
18 to Royal until we had an opportunity to intervene  
19 and object to Royal's request for our documents.

20 The next morning, October 14th, less  
21 than one day after, with less than one day to go  
22 before production was supposed to occur,  
23 Ms. Auerbach Emailed me back to say they planned  
24 on complying with the subpoena.

151

1 I called Ms. Auerbach later in the  
2 day to inquire why it was that she was planning  
3 on complying when I believed that was a clear  
4 breach of the confidentiality agreement that had  
5 been entered into between McGladrey and the  
6 Trustee. And I also -- and Ms. Auerbach's answer  
7 was because she believed it would be a benefit  
8 of -- a benefit to the estate to produce the  
9 documents to Royal.

10 I asked Ms. Auerbach to explain how  
11 the would be of benefit to the estate, and she  
12 said that she couldn't say anything further  
13 except that it would be consistent with the  
14 Trustee's settlement with Royal.

15 When I told her I was not aware of  
16 any kind of settlement with Royal, could she  
17 explain that to me, and explain the terms of the  
18 settlement to me, she said -- she said that she  
19 couldn't tell me anything further, that it was --  
20 it should be on the public docket, and that she  
21 had probably already told me too much.

22 We believe Royal's subpoena is  
23 simply an attempt to obtain improper pre-claim  
24 discovery for a civil lawsuit that has absolutely

1 no bearing on the interest of the estate.

2 Let me tell you initially why we  
3 think that's clear. On October 14th, having  
4 received the Royal subpoena, my partner Richard  
5 Swanson contacted Mr. Gilbert and counsel for  
6 Royal to talk about Royal's request for our  
7 documents.

8 Mr. Swanson, in the course of that  
9 conversation, asked Mr. Gilbert what he believed  
10 the benefit to the estate would be for Royal to  
11 obtain our documents.

12 Mr. Gilbert refused to respond to  
13 that inquiry. My partner, Mr. Swanson, also  
14 asked Mr. Gilbert whether Mr. Gilbert would agree  
15 to accept McGladrey's documents pursuant to a  
16 protective order, pursuant to which an ethical  
17 wall would be erected between people at Royal who  
18 are interested in pursuing estate claims, and  
19 people at Royal who would be interested in  
20 pursuing civil litigation claims against  
21 McGladrey.

22 Tellingly, Mr. Gilbert refused that  
23 request, as reasonable as it was. It's clear to  
24 us, based upon our conversations with

1 Ms. Auerbach and Mr. Gilbert, that Royal is  
2 trying to use the settlement or the proposed  
3 settlement with the Trustee to obtain our  
4 documents.

5 But even were a settlement to be in  
6 place, there's no legitimate reason for Royal to  
7 be obtaining our documents. In its opposition  
8 papers to our motion to quash, Royal allowed the  
9 necessity of exploring claims against McGladrey.  
10 Yet, the Trustee has had our documents for over  
11 eight months for exactly that purpose.

12 And the Trustee has clearly  
13 indicated to us that, and said that it has  
14 absolutely no intention of seeking any claims  
15 against McGladrey. Those statements were made by  
16 Mr. Derrick Dyer in a letter to me in connection  
17 with our second production of documents to the  
18 Trustee.

19 And in that letter, Mr. Dyer  
20 clarified that the reason why the Trustee wanted  
21 to review our documents was not to investigate  
22 claims against McGladrey, but rather to  
23 investigate claims that the Trustee was likely  
24 going to make against Pepper Hamilton.

1           Following that, Ms. Auerbach wrote  
2     back and softened Mr. Dyer's letter. But in a  
3     conversation that I had with Ms. Auerbach, she  
4     clearly stated to me that there was no current  
5     intention of bringing a claim against McGladrey,  
6     and likely never would be. She simply could not  
7     make that official, because it would be  
8     inappropriate, given the procedural stance of the  
9     case.

10           The terms of the settlement and  
11    everything we heard today indicates that  
12    McGladrey is not being considered for a lawsuit,  
13    and with good reason. The estate would clearly  
14    face insuperable in pari delicto -- in pari  
15    delicto problems if it were to attempt to claim  
16    against McGladrey.

17           As Mr. Stanziale testified today,  
18    their allegations are fraud all over the place,  
19    and it's a fraud that was committed by  
20    Mr. Yao.

21           And if that's the case, the estate  
22    cannot sue McGladrey for not having caught that  
23    fraud without facing an insuperable in pari  
24    delicto case.



155

1 THE COURT: I don't have to decide  
2 that today, do I?

3 MS. RENDON: I think you're right.

4 THE COURT: I mean, the estate's got  
5 the documents. You have no problem -- I gather  
6 you knew that there was a possibility that they  
7 might sue you and use those documents.

8 MS. RENDON: That's correct, Your  
9 Honor.

10 THE COURT: I mean, you took that  
11 risk.

12 MS. RENDON: Yes.

13 THE COURT: Which what you are  
14 saying is you didn't take the risk that Royal,  
15 acting on their own behalf, would have access to  
16 those documents?

17 MS. RENDON: I think --

18 THE COURT: By way of the Trustee or  
19 anybody else that might choose to sue you?

20 MS. RENDON: That's exactly right,  
21 Your Honor. In fact, when we entered into the  
22 confidentiality agreement, we were specifically  
23 trying to guard against exactly that risk by --  
24 and that is why we entered into the

156

1 confidentiality agreement, because we were not  
2 willing to sign on for that risk.

3 We were certainly willing to  
4 cooperate with counsel for the Trustee, though,  
5 and Your Honor, it just appears so clear to us,  
6 given Mr. Gilbert's unwillingness to enter into  
7 the protective order, and given a complete  
8 failure even as of right now to articulate a real  
9 need for Royal to have our documents when the  
10 Trustee has had them for eight months, and had  
11 the ability to analyze them for our documents to  
12 be made available to Royal.

13 And it's clear that Royal's 2004, as  
14 broad as it is, cannot -- does have its limits.  
15 It cannot be used to circumvent the requirements  
16 of Federal Rules of Civil Procedure.

17 Rule 9016 of the Bankruptcy  
18 Procedure Rules incorporates Rule 45, which in  
19 turn is governed by rule, Federal Rules of Civil  
20 Procedure Rule 26.

21 And under those rules, you cannot  
22 take pre-claim discovery until after a claim is  
23 filed. Those types of concerns were raised in  
24 the In Re: Continental Forge case, in the In Re:

157

1 Enron case, in the In Re: Nyder versus Society  
2 Bank case.

3 And in all of these cases, Royal's  
4 2004 requests for documents were turned down  
5 because the belief was that they were really  
6 trying to obtain information for interests  
7 unrelated to the estate, but interests to further  
8 a private litigation. And that is clearly an  
9 improper purpose of Rule 2004.

10 Each one of those cases I just cited  
11 to Your Honor express the concern that Rule 2004  
12 discovery cannot be used to circumvent the  
13 safeguards of the Federal Laws of Civil  
14 Procedure, and that is exactly what Royal is  
15 attempting to do for all these reasons, because  
16 Royal does not have standing to have issued the  
17 subpoena, because it was improperly noticed,  
18 because it wasn't done on a notice motion.

19 And most importantly, because the  
20 subpoena is trying to be used to circumvent the  
21 requirements of the Federal Rules of Civil  
22 Procedure. We respectfully request that the  
23 subpoena be quashed.

24 Thank you, Your Honor.

1 THE COURT: Thank you.

2 Royal.

3 MR. BICKS: Good evening, Your

4 Honor. John Bicks of Sonnenschein, Nath &

5 Rosenthal for Royal Indemnity.

6 Your Honor, obviously to hear the

7 presentation from McGladrey, you might lose sight

8 of a couple of the basic touchstones of the issue

9 that's really before you.

10 We are talking about documents that

11 are indisputably not privileged documents that

12 have already been produced to the Trustee.

13 THE COURT: What right do you have

14 to them?

15 MR. BICKS: Your Honor, you heard a

16 lot of testimony today from Mr. Stanziale, a lot

17 of argument about Royal's willingness to step up,

18 put the money where its mouths is, and put almost

19 \$5 million of seed capital into this estate.

20 And the principal purpose of that

21 settlement from the estate's perspective is it

22 gives the estate the ability to investigate

23 claimants, and it certainly is clear why

24 McGladrey ought to be concerned that the estate

159

1 might very well want to assert not only claims --

2 THE COURT: But if this is an estate  
3 claim, why does Royal have a right to these  
4 documents?

5 MR. BICKS: I think, were we not  
6 before you, Your Honor, this afternoon also on  
7 the motion to approve the settlement, whereby  
8 Royal was going to act in partnership with the  
9 Trustee, to help the Trustee.

10 THE COURT: But even if that's the  
11 case, this would be a Paragraph 7 action, if, in  
12 fact, the Trustee determined not to bring the  
13 action.

14 MR. BICKS: It could qualify if the  
15 Trustee chose not to bring the action. That's  
16 absolutely true.

17 THE COURT: So you haven't any right  
18 at the moment to bring an action on behalf of the  
19 Trustee, do you?

20 MR. BICKS: We don't have an  
21 approved settlement. Your Honor has taken it  
22 under advisement.

23 THE COURT: Even if I did, does the  
24 approved settlement give you automatic right to

160

1 bring action?

2 MR. BICKS: Only after the Trustee  
3 takes a pass.

4 THE COURT: And the Trustee hasn't  
5 taken a pass.

6 MR. BICKS: That is correct. I  
7 think it's also important that the record be  
8 accurate, what the Trustee has done, and what the  
9 Trustee has said and not said about what its  
10 willingness is to --

11 THE COURT: Well, I would assume --  
12 I mean, whether the Trustee told them they didn't  
13 think it was going to sue them at all, I don't  
14 really care what at this point.

15 If you had a settlement and if the  
16 provisions were triggered that you could bring  
17 the action, maybe you might have the right to the  
18 documents from the Trustee. But we're not there  
19 now, are we?

20 MR. BICKS: We are not there in the  
21 sense that two things have not happened, Your  
22 Honor.

23 One, Your Honor has not approved the  
24 settlement.

161

1 And, two, the Trustee has not  
2 reviewed and taken a pass.

3 The other issue that you have to  
4 look at, this whole issue, I think in fairness  
5 under the real life time line that we're  
6 currently presented with, and that is that next  
7 week certain statutes of limitation will arise  
8 and will bar or may bar.

9 THE COURT: Hey, I didn't create  
10 that problem, gentlemen and ladies. That date  
11 was set two years ago, and you just got around to  
12 settling your case.

13 You may have to bring your own  
14 lawsuits.

15 MR. BICKS: Understood. I  
16 understand Your Honor.

17 That may very well happen.

18 THE COURT: That may be. But what  
19 you're telling me is that part of what you bought  
20 is the right to get information from the Trustee  
21 even before the settlement came before me.

22 MR. WOLFSON: Your Honor --

23 THE COURT: That I find a little  
24 offensive, frankly.

162

1 MR. WOLFSON: First -- first couple  
2 of points.

3 Under 2004, I think that we, as a  
4 creditor of the estate, have the absolute right  
5 to try to review any and all documents that  
6 impact the action, conduct, property of this  
7 estate. To the extent these documents impact the  
8 act, conduct and property of the estate, I don't  
9 understand counsel's point of view that we  
10 have -- just because we might have some other  
11 potential claims which we have not brought  
12 against them, the fact that I might have another  
13 potential individual claim doesn't mean that we  
14 can't exercise our rights under 2004, and look at  
15 the act, conduct, property of this estate.

16 That's point number one.

17 Point number two is we are trying to  
18 cooperate with the Trustee. We are trying to  
19 work with the Trustee and understand where the  
20 Trustee is coming out.

21 On the McGladrey issue, they have  
22 not definitively said to us that they are or are  
23 not going to bring the action, although clearly  
24 they're leaning on not bringing it. A good



163

1 portion of why they're leaning that way is  
2 because of what we perceived may be a  
3 misunderstanding of the in pari delicto defense  
4 where, while it may be applicable under a 541  
5 action, it is not applicable under a Section 544  
6 action.

7 And we are working diligently with  
8 the estate in order to enable the Trustee to  
9 better understand our perspective. This may be  
10 an important asset of the estate for an estate  
11 claim, not an individual creditor claim.

12 And to the extent it's an estate  
13 claim, we just want to be able to have the  
14 information.

15 THE COURT: When does the statute of  
16 limitations run?

17 MR. WOLFSON: You have two -- my  
18 understanding is you have two years to bring the  
19 action from the commencement of the case.

20 THE COURT: So it ends --

21 MR. WOLFSON: November 3rd, it ends.  
22 It ends next week.

23 So we have a couple of days.

24 THE COURT: So that's why you felt

164

1 you could issue a subpoena on 36 hours' notice?

2 MR. WOLFSON: We told them -- first,  
3 we believe that this subpoena was issued.

4 THE COURT: Why wasn't the subpoena  
5 issued on them?

6 MR. WOLFSON: Well, because --

7 THE COURT: Why do you need the  
8 Trustee if you truly are doing a 2004?

9 MR. WOLFSON: Right.

10 THE COURT: And you want somebody's  
11 documents.

12 MR. WOLFSON: Well, I can take a  
13 2004 of a Trustee.

14 THE COURT: Yeah, I know you can.

15 MR. WOLFSON: That is what we're  
16 trying to do.

17 THE COURT: Yeah, but the Trustee --  
18 you're putting the Trustee in the position of the  
19 soft confidentiality agreement being entered and  
20 now you're basically prostituting him by making  
21 him give up those documents because of the  
22 settlement. The settlement isn't approved.

23 MR. WOLFSON: I understand.

24 THE COURT: And if you want me to

165

1 deny the settlement because you're doing an end  
2 run around instead of going directly to the  
3 source, you're very close to it.

4 MR. WOLFSON: No, we don't. We're  
5 not basing our right to the documents on the  
6 settlement. Either they're approved or not  
7 approved.

8 What we understood from the Trustee  
9 who has said to us -- we have been collaborating  
10 and working with the Trustee to try and get into  
11 a better -- a better arrangement, so that we're  
12 working cooperatively instead of at odds. And we  
13 have been sharing information.

14 We have been trying to share our  
15 point of view. They've been sharing their point  
16 of view.

17 Of all the lawsuits out there, this  
18 is one -- this is one potential lawsuit that  
19 we've been exploring with them. And what we  
20 wanted to do is see what documents they're  
21 looking at.

22 Now, yes, we understand there's a  
23 confidentiality agreement. We read the  
24 confidentiality agreement, and candidly, we

166

1 thought that that confidentiality agreement  
2 absolutely permits the Trustee in the context of  
3 this sort of a collaboration, with or without a  
4 settlement agreement, given it has the right to  
5 share this sort of a document with another  
6 creditor of the estate in order to help the  
7 Trustee determine what to do on that action.

8 We asked for it. And I believe my  
9 understanding is that counsel for the Trustee  
10 believes that that's the appropriate analysis of  
11 that agreement, also.

12 But counsel for McGladrey objected,  
13 and out of an abundance of caution, counsel for  
14 the Trustee said, Look, we read this agreement.  
15 We think we can give it to you.

16 We think McGladrey is making a big  
17 fuss about it. We don't want to get sued by  
18 McGladrey, because we're giving you documents  
19 that we thought we could.

20 So would you give us a subpoena?  
21 That's how that came about.

22 And, yes, we are faced with a time  
23 line by which the Trustee needs to decide whether  
24 to bring a lawsuit, and with or without this